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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

MONDAY, MAY 21, 1984 VOLUME XXI, NUMBER 20

To Accommodate Or Not . . .

With the release of a barrage of upbeat April economic numbers in recent days, the long-awaited slowing in the pace of business seems further away than ever—unsettling the credit markets, sending securities prices lower and interest rates decidedly higher. And, as if on cue, Wall Street again demonstrated that it prefers to march to the tune of a different drummer than Main Street, shrugging off what would normally be exceptionally favorable economic news: A business expansion which remains solidly on track, still modest rates of inflation and within-target money growth.

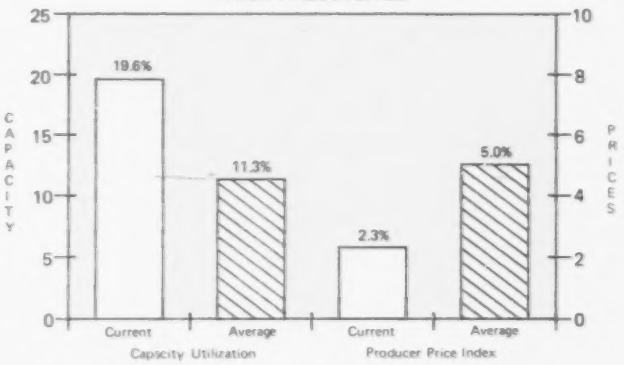
What is troubling the debt markets, and the stock market as well, is not today's news but what they think will be tomorrow's. For with the economy growing rapidly, swelling household and business credit demands are sure to clash head-on with Washington's enormous borrowings—as long as the Federal Reserve sticks to its inflation-fighting monetary policy stance. If it does, upward pressures on interest rates will only intensify. If it doesn't, inflation expectations will be reawakened—a policy-maker's Hobson's choice in which, whatever the decision, the credit markets in general, and the bond markets in particular, lose.

To be sure, the perceived strength of the economy will be one of the primary influences on future monetary policy, the near-term course of which will be decided upon by the central bank's Federal Open Market Committee (FOMC) this week. For although business activity did taper off in March, due in large measure to severe weather in many parts of the country, the pause was short-lived. In April, retail sales snapped back from the declines of February and March and housing starts rose smartly. For their part, the industrial production, capacity utilization and personal incomes numbers all suggest continued business strength. Under these conditions, fears of economic "overheating" are again widespread, as is the belief that the Fed will soon tighten the money and credit reins in order to forestall the reignition of inflation expectations.

. . . That's The Fed's Question . . .

But, so far at least, rising production levels and capacity utilization rates have yet to translate into significant cost-price pressures—the major concern at the Fed. For, as shown in the chart, despite the fact that the rate of rise in capacity utilization during this recovery is now running well ahead that of past cyclical experience, the rate of rise in prices is not. At the producer level, for example, the rise in prices is slower this time around than in the past—even though operating rates in such key industries as paper, rubber, electrical machinery and autos have been averaging either far above or near the 85 percent mark.

PERCENT CHANGE FROM END OF RECESSION IN CAPACITY UTILIZATION AND PRODUCER PRICE INDEX: CURRENT RECOVERY VS. AVERAGE OF PRIOR 7 RECOVERIES



One reason for this could be the possibility that linkages between operating rates and price increases in specific industries are not all that clear-cut. With the exception of the paper industry of the four named above, the rate of rise in producer prices was actually faster during the 1981-82 recession, when capacity utilization rates were declining sharply, than they have been since—when they were rising sharply! In the exception, the paper industry, the price gain during the two periods was just about equal. This suggests that despite the fact that several industries are operating near capacity, it has yet to spill over in any significant way into either their product prices or overall rates of inflation.

Nor should trends in the money supply numbers be a cause of undue FOMC concern. This is because while the M1 money supply may well continue to expand strongly in May, much of the gain can be

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traced to the stepped-up distribution of individual income tax refunds. Even so, as money growth accelerates and begins to rise toward the top end of 1984's growth target boundaries, this development, together with signs of ongoing business expansion, will undoubtedly depress market sentiment. That, however, is in the future, for now, year-to-date M1 growth is still within its target boundaries, as is M2.

. . . As Credit Demands Surge

If neither today's rates of capacity utilization, inflation nor money growth warrant additional Fed restraint, one principal source of Fed concern may be the pronounced, and sustained upturn in private credit demands. With housing starts continuing at a high level and auto purchases remaining strong, household borrowings have yet to show any sign of fading. During the first quarter of 1984, for example, installment debt acquisitions surged at their fastest clip since the late 1970s. And, while household borrowings have been outdistancing gains in incomes in recent months, the key installment debt-to-disposable income ratio remains well below the peak reached in late 1978. In fact, households could add another $40 billion to installment debt outstanding before reaching the 1978 debt-to-income ratio peak. This means that the torrid, first-quarter borrowing clip could last the rest of this year—as long as consumer confidence holds up.

So, too, business borrowings are surging. This is

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit	5/16/84		
U.S. Gov'ts and Agencies Owned Outright & RPs	161.122	– 2.743	+12.408
Loans to Depository Inst.	4.613	+ 3.515	+ 3.540
Float	.029	– .863	– 1.493
Total Reserve Bank Credit	174.893	– .517	+14.900
Treasury Deposits with Federal Reserve Banks	3.521	– 2.130	+ .390
Currency in Circulation	172.123	+ .699	+13.244
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	114.378	+ .283	+ 4.407
	5/9/84		
Member Bank Reserves:			
Total Reserves Held	35.880	– 1.064	+ 1.921
Excess (Deficiency)	.603	+ .036	+ .195
Net Borrowed Reserves	.282	– .665	+ .580
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates †			
M1 (5/7/84)	539.4	+ 3.6	+ 7.2
M2 (April '84)	2,242.1	+ 6.4	+ 7.7
M3 (April '84)	2,790.6	+ 10.1	+ 9.4
Domestic Nonfinancial Debt (4th Q'83)	5,219.0	+ 10.6	+ 10.8

†Seasonally adjusted. * Seasonally adjusted annual rate.

New York Money Market

Offering Rates 5/18/84	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	10.06%	11.05%	11.75%
* Federal Agencies	10.70	11.25	11.85
* Project Notes—Taxfree (46% Taxable Equivalent)	10.28	10.65	11.85
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	11.30	11.85	12.60

‡Finance Company Paper—Prime

5- 14 days	8.75%
15- 29 days	9.50
30- 59 days	10.20
60- 89 days	10.65
90-179 days	10.75
180-239 days	10.25
240-270 days	10.25

‡* Bankers' Acceptances

Jun.	10.75%
Jul.	10.85
Aug.	11.10
Sep.	11.25
Oct.	11.35
Nov.	11.35

‡Industrial Paper—Prime

30- 89 days	10.55%
90-120 days	10.75

†Federal Funds Effective Rate 9.00%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'84	$ 3,542r	$ 3,436	$ 3,172
Gross National Product (1972 Dollars)*	1st Q'84	$ 1,606r	$ 1,573	$ 1,490
Percent Change, Annual Rate	1st Q'84	8.8r	5.0	2.6
Change in Consumer Prices (new series)*	Mar '84	2.4%	4.8%	1.2%
Change in Producer Prices*	Apr '84	0.0%	6.0%	0.0%
Civilian Employment (Thousands of Persons)†	Apr '84	104,402	104,140	99,606
Unemployment as % of Civilian Labor Force†	Apr '84	7.8%	7.8%	10.2%
Personal Income*	Apr '84n	$ 2,957	$ 2,942r	$ 2,689
Leading Indicators Composite Index (1967=100)†	Mar '84	165.5	167.3	150.2
Industrial Production Index (1967=100) †	Apr '84n	163.1	160.9r	142.6
Net Change in Consumer Installment Credit †	Mar '84n	$ 5.87	$ 6.61	$ 2.58
U.S. Merchandise Trade Balance †	Mar '84	–$ 10.26	–$ 10.09	–$ 3.70
Plant and Equipment Expenditures*	2nd Q'84	$335.40(a)	$332.66(a)	$293.46
Private Housing Starts (Thousands of Units)*	Apr '84n	1,963	1,645r	1,549
New Construction Expenditures*	Mar '84	$ 295.6	$ 292.0	$ 241.9
Total Business Inventories †	Mar '84n	$ 531.8	$ 527.6r	$ 499.4
Total Business Sales †	Mar '84n	$ 400.7	$ 398.8r	$ 348.2

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

because with inventory outlays rising sharply, equipment spending still robust and plant outlays increasing as well, business spending is now running well ahead of business cash flow. And, with both the bond and equity markets in disarray, a good chunk of the resulting corporate finance needs is being met at the commercial banks and in the short-term debt market.

Commercial and industrial loans as well as commercial paper issuance have both soared in recent months. Although some of the strength in business borrowings can be traced to stepped-up merger and acquisition activity, it also stems from increased working capital and investment spending needs. Add to this the fact that the Treasury remains a substantial borrower of funds, and it is hardly surprising that the growth of nonfinancial sector debt in recent months has been expanding at double-digit annual rates.

Swelling credit demands, along with the unwillingness of the Fed to be entirely accommodative toward these credit needs, represent a one-two punch that has been sending yields higher across the entire maturity spectrum. Nor is this situation expected to change anytime soon, despite today's well-behaved rates of inflation and money supply growth. For the Fed finds itself with little option but to stick to its guns and allow interest rates to move higher, hoping to dampen the pace of business just enough to keep inflation moderate—but not so much as to raise the threat of a new recession. M

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (5/2/84)	141,983	+ 423	– 6,487
New York City (5/9/84)	29,739	+ 655	– 3,900
Commercial Paper (5/9/84)	208,478	– 216	+37,807

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/2/84)	236,452	+ 1,721	NA*
New York City (5/9/84)	62,977	+ 722	NA*

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/2/84)	602,809	+ 4,891	NA*
New York City (5/9/84)	135,139	– 1,356	NA*

*Year ago data not available due to definitional changes.

Financial Markets

	Friday 5/18/84	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	10.06%	– .24	+ 1.46
180-Day Bills†	11.05	+ .15	+ 2.22
Longest Bills†	11.75	+ .20	+ 2.65
Recent Issues:			
11 3/4s 4/30/86	12.54	+ .04	
12s 3/31/88	13.10	+ .10	
13 1/8s 5/15/94	13.59	+ .09	
13 1/4s 5/15/14	13.62	+ .07	
Municipals:			
Bond Buyer–20 Bond Index* (5/17/84)	10.36%	+ .17	+ 1.07
Blue List Total ($ Million)	$1,566	+ $ 81	+ $ 90
30-Day Visible Supply ($ Million)	$2,744	– $313	– $1,570
Total	$4,310	– $232	– $1,480
Corporates:			
Moody's Aa Composite (5/17/84)	14.23%	+ .27	+ 2.20
30-Day Visible Supply ($ Million)	$1,915	+ $150	+ $ 800
Stocks:			
Dow-Jones Averages:			
Industrials	1,133.79	– 23.35	– 56.13
Transportation	474.59	– 27.47	– 65.03
Utilities	127.31	– 1.98	– 1.57
65 Stocks	441.21	– 12.95	– 28.91
Standard and Poor's 500 Stocks	155.78	– 2.71	– 6.36
N.Y.S.E. Composite Index	89.56	– 1.67	– 4.15
N.Y.S.E. Avg. Daily Vol. for Week (000's)	82,904	–16,450	+ 408

* 46% Taxable equivalent 19.19%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 5/18/84	Week Ago
Overnight	9.25%	10.06%
1 month	10.88	10.63
3 month	11.75	11.81
6 month	12.31	12.13
1 year	12.94	12.75
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	12.90%	12.90%
Long Term (7 to 15 yrs.)	13.15	13.10

FOREIGN EXCHANGE SPOT RATES

New York Opening (5/18/84)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01776	56.31
Canada	.7717	1.2959
Denmark	.0986	10.1450
France	.1175	8.5100
Germany	.3606	2.7735
Italy	.0005855	1707.80
Japan	.004288	233.20
Mexico	.005063	197.50
Netherlands	.3209	3.1160
Switzerland	.4387	2.2795
U.K.	1.3872	.7209

MANUFACTURERS HANOVER ★ WESTCHESTER CLASSIC ★

Great golf! Great cause! Great price!

The Manufacturers Hanover Westchester Classic is at the Westchester Country Club in Harrison, New York. June 4th-10th.

- Tickets for the Sports House and grounds for 7 days – $60. Grounds only – $45. Monday and Tuesday (qualifying and practice rounds) – $5 or $3 per day. Wednesday (the Pro-Am) – $10 or $6. Thursday, Friday, Saturday, Sunday – $18 or $15 each day.
- Seve Ballesteros, defending champion, and other top pros from the PGA Tour, will compete for $500,000 in prize money, and the winner's purse of $90,000.
- Proceeds help support these area hospitals: United, Lawrence Auxiliary, New Rochelle, Northern Westchester, Phelps Memorial, St. Agnes, St. John's, St. Joseph's, St. Vincent's, Blythedale Children's, Greenwich, Mt. Vernon, White Plains, Yonkers General.
- Tickets on sale at all these hospitals through June 3rd, then at the gate. To charge with MasterCard or VISA call (212) 808-8100.
- For more information call (914) 967-5356.

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